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SUBJ: American Low Cost Carriers service to Canada set to increase

¶1. (U) Summary: On May 25, Frontier Airlines became the first American Low Cost Carrier (LCC) in over a decade to fly scheduled passenger service between U.S. and Canadian destinations. Recent developments in aviation technology coupled with the seven (soon to be eight) CBP preclearance sites in Canada have created increased economic desirability of some transborder routes for LCCs. Frontier's route start-up may be the beginning of a trend as other LCCs will soon contemplate transborder routes or are in the process of converting from domestic to international air carriers. End summary.

¶2. (U) Under the 1995 Air Transport Agreement between Canada and the United States, as amended last November, there are no government imposed restrictions preventing U.S./Canada routes by any U.S. or Canadian passenger carrier; carriers are limited only by the economic viability of the routes. Canadian LCCs such as WestJet and CanJet have recently begun transborder flights, but the absence of American LCCs from any transborder routes for the past 10 years indicates the economics of such routes has been questionable from their perspective, until now.

¶3. (U) On May 25, Frontier Airlines began flying a route between Denver and Calgary, becoming the first American LCC to fly a transborder route between the U.S. and Canada since ValuJet Airlines flew from U.S. cities to Montreal in the mid-90s. Frontier now flies two non-stops per day between the two cities through its JetExpress service on 70 seat regional jets operated by Horizon Air. Alaska Airlines also flies to Canada mostly through similar regional jets operated by Horizon Air, though it is debatable whether the air carrier should be actually classified as a LCC. In either case, even with the new transborder flights, there are relatively few LCC flights operating between the U.S. and Canada versus those to Mexico and the Caribbean. If Alaska Airlines is included, then two separate American LCCs fly to Canada, serving six Canadian destinations. By contrast, U.S./Mexico transborder routes are served by five American LCCs and include flights from U.S. cities to 14 Mexican airports. Likewise, the Caribbean region is served by five American LCCs, flying between U.S. cities and 16 destinations.

¶4. (U) Factors contributing to the relative lack of US LCC transborder activity in Canada include additional taxes and fees relative to domestic operations (e.g. International Departure and Arrivals taxes, Customs Inspection fees and so on) and the difficulty of starting new service at the major hubs of Montreal, Toronto and Vancouver to successfully compete with entrenched legacy carriers. But it is the availability of U.S. CBP staff that appears

to be the overriding "limiting factor." Though LCCs can travel to any Canadian airport, return flights require customs inspections for customers and aircraft when coming back in the US. Such inspections can double the time a plane is on the ground between flights, and also limits routes to designated "international airports." For an LCC with a "time is everything" business strategy the lost time is lost money. LCCs' traditionally prefer to use secondary airports with lower overhead, but which may not be a designated international airport and therefore have no or limited availability of CBP. Thus CBP preclearance at the Canadian airport is a key factor in the QCBP preclearance at the Canadian airport is a key factor in the business decision to undertake service. In talking to representatives of Frontier, and another American LCC, Airtran, both noted that the presence of preclearance sites was a "prerequisite" to even considering a route to a Canadian airport. Airtran specifically commented that they had considered Hamilton, Ontario but had dropped the plan in large part because of the absence of CBP personnel there.

¶5. (U) The use of Regional Jets (RJs) coupled with the expansive array of Canadian CBP preclearance sites in Vancouver, Calgary, Edmonton, Winnipeg, Toronto, Ottawa, Montreal, and beginning in October 2006, Halifax may have made more routes economically viable for American LCCs. Both legacy carriers and LCCs have been increasingly using 50- or 70-seat RJs as an alternative to larger jets. The advantages of these RJs, many of which are produced by Canadian-based Bombardier, are two-fold. The operating cost per hour of use for RJs is significantly less than the LCCs' more traditional jets like the Boeing 737 and Airbus A320. Secondly, smaller jets can adjust for a smaller potential volume of passengers, thus keeping costs down by flying full RJs rather than half-filled larger jets. With lower costs, American LCCs are now finding additional incentive to fly to Canadian cities with CBP preclearance sites than under previous conditions.

¶6. (U) Comment: Since the Air Transport Agreement of 1995, there

has been very few impediments to American passenger carrier operations in Canada and vice versa. The remaining impediments will be remedied by the recent amendment to the 1995 Agreement (expected to come into force in the fall of 2006); however, the changes to the 1995 Agreement will have negligible impact on LCC decisions to enter the transborder passenger marketplace. Rather, economic viability of service is the sole factor - and the key elements for viability are CBP preclearance coupled with RJ operations. Indeed, Frontier's new Denver-Calgary route was made economically viable through the use of regional jets and the ability to fly a route to a smaller airport sufficiently large to have CBP preclearance facilities. This suggests that we may see more American LCC operations into Canada's secondary airports such as Calgary, Edmonton, Winnipeg, Ottawa and Halifax, rather than into the three major international hubs. Frontier's venture into transborder travel should be looked at in the bigger LCC picture. In its May Directors Meeting, Southwest Airlines addressed this issue. Southwest management concluded that transborder routes were a definite possibility as soon as the carrier changes over from domestic to international carrier status. Southwest estimated this would be done by 2008. ATA (please note this LCC has no affiliation with the similarly named Airtran Airways) will be investigating transborder routes during mid-2007. And then there are a number of Canadian LCCs, including WestJet and CanJet, showing the economic viability of many routes by opening up over a dozen transborder routes in the past three years alone. All these indications suggest that there is potential growth of U.S. LCC operations on transborder routes. End comment.

Wilkins